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February 20, 2008

AGENDA ITEM 7a

TO: MEMBERS OF THE HEALTH BENEFITS COMMITTEE

I. SUBJECT: Hospital Cost Efficiency Report

II. PROGRAM: Health Benefits

III. RECOMMENDATION: Information Only

IV. BACKGROUND:

The CalPERS Board of Administration approved the Partnership for Change in 2005 to promote value in hospital care and help moderate costs. The goal is to establish a transparent and well-functioning marketplace where hospitals will compete for business on the basis of the quality and cost of the services they deliver. The Partnership for Change includes:

- CHART – the California Hospital Assessment and Reporting Taskforce
- HVI – the Hospital Value Initiative

CHART is a collaborative effort to publicly report hospital quality, led for the last three years by the University of California, San Francisco, and the California HealthCare Foundation. The CHART collaborative launched the CalHospitalCompare Web site to report the performance of individual California hospitals to consumers, purchasers, and health plans. Representatives of hospitals, health plans, health care purchasers (including Loren Suter representing CalPERS), and consumers are members of the CHART Board of Directors.

HVI is sponsored jointly by CalPERS, the Pacific Business Group on Health (PBGH) and the California Health Care Coalition (CHCC). The expected outcomes of the HVI are to: 1) build consensus among California stakeholders on a standard set of cost-efficiency metrics for our marketplace; and, 2) develop a measurement system and reporting framework for generating and disseminating comparative hospital-level results for both cost and quality. Representatives of hospitals and health plans participated with CalPERS, PBGH and CHCC on the HVI Steering Committee.

This agenda item is an update on the HVI project and the release of a new

report, *Cost Efficiency at Hospital Facilities in California: A Report Based on Publicly Available Data.*

Loren Suter, Senior Strategic Advisor to CalPERS, transmitted the report and Executive Summary to the CalPERS Board of Administration on January 17, 2008.

V. ANALYSIS:

Hospital costs are both the largest portion of the health care premium and the fastest growing. The only way to decrease prices, increase quality, and force hospitals to be more efficient is to increase the transparency of health care costs and quality.

Below are discussions of:

- Current status of HVI collaborations with health plans and hospitals
- The new report issued by CalPERS and PBGH, *Cost Efficiency at Hospital Facilities in California: A Report Based on Publicly Available Data*

Status of HVI Collaborations

In 2005, the HVI began collaborating with Blue Cross, Blue Shield, HealthNet, United/Pacific Care and Aetna to use their commercial paid claims files to determine risk-adjusted pricing at the major service line level (e.g., Orthopedics, Cardiac, Maternity, etc.). The HVI planned to compare this cost information with hospital clinical quality information provided by the CHART project (www.calhospitalcompare.org), but in October, 2006 the hospitals objected to the publication of paid claims information and threatened the health plans with lawsuits if the health plans continued to cooperate with the HVI. The hospitals contended that confidentiality waivers must be provided to the health plans in order for the health plans to supply paid claims data. The hospitals refused to provide such waivers; therefore, the health plans were unwilling to risk large litigation costs and ceased cooperating with the HVI.

The hospitals also contend that publication of claims payment information is a violation of antitrust laws. Although the HVI obtained a legal opinion from HVI antitrust counsel and shared that opinion with the hospitals, the hospitals were unconvinced. Several hospitals and the California Hospital Association obtained their own antitrust counsel, but they have not made their counsels' opinions available to the HVI. As a result, the HVI filed a request for a business review letter with the federal Department of Justice (DOJ) on November 15, 2007. Based on conversations with both the DOJ and the Federal Trade Commission, a favorable ruling should be expected in the next 60-90 days.

As stated earlier, HVI's goal is to bring together both quality and cost information to determine the true value of care by service line for each hospital in California. To do this, we need cost information at the major service-level (cardiac,

orthopedic, maternity, etc.). To date, the hospitals have not been willing to provide the necessary data publicly. Therefore, we believed that we needed to provide information that verified the data developed when CalPERS made the decision to eliminate high-cost hospitals from its managed care network. Our belief was that the information would help convince health care stakeholders to demand hospitals to participate in our efforts. As a result, CalPERS and PBGH worked with Milliman Consulting and Actuaries to develop a methodology that uses publicly available data to determine both the cost of hospital operations and the prices charged by hospitals for their services.

Issue of the New Report: *Cost Efficiency at Hospital Facilities in California*

The results of this effort is the report released by CalPERS and PBGH, *Cost Efficiency at Hospital Facilities in California: A Report Based on Publicly Available Data*, which compares hospitals on costs incurred to provide services and on charges collected from private payers and patients. The variation across both parameters is large: 3 to 1 on costs and 6 to 1 on charges.

We have attached the Executive Summary for reference. The report uses two measures of hospital cost efficiency: a Buyer Cost Index (BCI) – what hospitals charge purchasers – and a Hospital Cost Index (HCI) – what it costs the hospital to provide the service. An index of 1.0 is average. Therefore, a BCI of 1.2 means that a hospital's pricing to purchasers is 20 percent *above* the regional average and a BCI of .85 means their pricing is 15 percent *below* the regional average.

A ratio of the buyer cost to the hospital cost (BCI/HCI) shows whether the costs and charges are consistent with each other. These comparisons are important. A ratio that is high may indicate overpricing by the hospital relative to its cost of supplying services. A ratio that is low may indicate good value if the hospital is providing low priced care at the same or better quality as other hospitals. A ratio that is low, however, may also be an indication of under-pricing by the hospital or an indication that the hospital is not charging enough to cover the costs of the services it provides.

The report also considers payer mix and regional variations, including the percentage of indigent and Medi-Cal inpatients. This percentage gives some idea of how indigent care may influence pricing.

Selected Highlights

The following are selected highlights of information contained in the report:

- CHW's Mercy General in Sacramento is an example of a hospital's costs and pricing having a low ratio. Mercy General's BCI is .811 and its HCI is .832. Therefore, Mercy General's pricing is in line with its costs. Mercy General's percentage of indigent care is 12.8 percent.

- Cedars Sinai is an example of a hospital's costs and pricing having a high

ratio. Cedars Sinai has an HCI of 1.43 and a BCI of 1.79 (see Table 2 and Table 4 of the Executive Summary). Cedars Sinai's operation costs are high and its pricing is even higher. Cedars Sinai's percentage of in-patient indigent care is only 11 percent – quite low for a large hospital.

- North Bay Medical Center is another high ratio example which has a BCI/HCI ratio of 1.789. North Bay Medical Center's BCI is 2.002 (its prices are 100 percent higher than the other hospitals in its region) and its HCI is 1.119. North Bay Medical Center's pricing is explained partially by indigent care (36 percent of its inpatients are indigent and Medi-Cal), but indigent care costs alone are not sufficient to justify the prices it charges.

It is apparent based on the data in the report that some hospitals are efficient and others are inefficient. Also, there are wide variations in the prices that hospitals charge. Some of these prices do not seem to have any correlation to the cost of providing services. Based on information contained in the report, we believe that it is imperative that hospitals agree to participate, in an open and constructive manner, in the HVI. Hospitals need to be publicly accountable for the efficiency of their operations and the prices they charge purchasers.

CalPERS and PBGH hope that those who use this report will help foster their efforts to promote greater transparency in hospital information and that all stakeholders – hospitals and other providers, employers, patients, lawmakers and regulators – will work together to slow the rising cost of health care for all Californians.

VI. STRATEGIC PLAN:

This item supports CalPERS Strategic Plan Goal 12 – "Engage and influence the health care marketplace to provide medical care that optimizes quality, access, and cost."

VII. RESULTS/COSTS:

This is an information item only.

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Executive Office

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Health Benefits Branch

Attachment